

change includes an extension or renewal of the agreement (other than an extension or renewal that results from another party to the transaction unilaterally exercising an option granted by the agreement) or a more than incidental change to any payment under the agreement. A change for the sole purpose of substituting the successor entity for the original tax-exempt party is not a material change.

(ii) *Exercise or nonexercise of options.* Nonexercise of an option pursuant to a transaction involving the tax-exempt entity generally will not constitute an act of approving or causing the entity to be a party to the transaction. If, pursuant to a transaction involving the tax-exempt entity, the entity manager exercises an option (such as a repurchase option), the entity manager will not be subject to the entity manager-level tax if the exercise of the option does not result in the tax-exempt entity becoming a party to a second transaction that is a prohibited tax shelter transaction.

(4) *Example.* The following example illustrates the principles of paragraph (c)(3)(ii) of this section:

*Example.* In a sale-in, lease-out (SILO) transaction described in Notice 2005-13 (2005-1 CB 630), X, which is a non-plan entity, has purported to sell property to Y, a taxable entity and lease it back for a term of years. At the end of the basic lease term, X has the option of “repurchasing” the property from Y for a predetermined purchase price, with funds that have been set aside at the inception of the transaction for that purpose. The entity manager, by deciding to exercise or not exercise the “repurchase” option is not approving or otherwise causing the non-plan entity to become a party to a second prohibited tax shelter transaction. See § 601.601(d)(2)(ii)(b) of this chapter.

(5) *Coordination with the reason-to-know standard.* The determination that an entity manager approved or caused a tax-exempt entity to be a party to a prohibited tax shelter transaction, by itself, does not establish liability for the section 4965(a)(2) tax. For rules on determining whether an entity manager knew or had reason to know that the transaction was a prohibited tax shelter transaction, see § 53.4965-6(b).

(d) *Effective/applicability dates.* See § 53.4965-9 for the discussion of the relevant effective and applicability dates.

[T.D. 9492, 75 FR 38702, July 6, 2010; 75 FR 46844, Aug. 4, 2010]

**§ 53.4965-6 Meaning of “knows or has reason to know”.**

(a) *Attribution to the entity.* An entity will be treated as knowing or having reason to know for section 4965 purposes if one or more of its entity managers knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity manager(s) approved the entity as (or otherwise caused the entity to be) a party to the transaction. The entity shall be attributed the knowledge or reason to know of any entity manager described in § 53.4965-5(a)(1)(i) even if that entity manager does not approve the entity as (or otherwise cause the entity to be) a party to the transaction.

(b) *Determining whether an entity manager knew or had reason to know—*(1) *In general.* Whether an entity manager knew or had reason to know that a transaction is a prohibited tax shelter transaction is based on all facts and circumstances. In order for an entity manager to know or have reason to know that a transaction is a prohibited tax shelter transaction, the entity manager must have knowledge of sufficient facts that would lead a reasonable person to conclude that the transaction is a prohibited tax shelter transaction. An entity manager will be considered to have “reason to know” if a reasonable person in the entity manager’s circumstances would conclude that the transaction was a prohibited tax shelter transaction based on all the facts reasonably available to the manager at the time of approving the entity as (or otherwise causing the entity to be) a party to the transaction. Factors that will be considered in determining whether a reasonable person in the entity manager’s circumstances would conclude that the transaction was a prohibited tax shelter transaction include, but are not limited to—

- (i) The presence of tax shelter indicia (see paragraph (b)(2) of this section);
- (ii) Whether the entity manager received a disclosure statement prior to

the consummation of the transaction indicating that the transaction may be a prohibited tax shelter transaction (see paragraph (b)(3) of this section); and

(iii) Whether the entity manager made appropriate inquiries into the transaction (see paragraph (b)(4) of this section).

(2) *Tax-shelter indicia.* The presence of indicia that a transaction is a tax shelter will be treated as an indication that the entity manager knew or had reason to know that the transaction was a prohibited tax shelter transaction. Tax shelter indicia include but are not limited to—

(i) The transaction is extraordinary for the entity considering prior investment activity;

(ii) The transaction promises an economic return for the organization that is exceptional considering the amount invested by, the participation of, or the absence of risk to the organization; or

(iii) The transaction is of significant size relative to the receipts of the entity.

(3) *Effect of disclosure statements.* Receipt by an entity manager of a statement, including a statement described in section 6011(g), in advance of a transaction that the transaction may be a prohibited tax shelter transaction (or a statement that a partnership, hedge fund or other investment conduit may engage in a prohibited tax shelter transaction in the future) is a factor relevant in the determination of whether the entity manager knew or had reason to know that the transaction is a prohibited transaction. However, an entity manager will not be treated as knowing or having reason to know that the transaction was a prohibited tax shelter transaction solely because the entity manager receives such a disclosure.

(4) *Appropriate inquiries.* What inquiries are appropriate will be determined from the facts and circumstances of each case. For example, if one or more tax shelter indicia are present or if an entity manager receives a disclosure statement described in paragraph (b)(3) of this section, an entity manager has a responsibility to inquire further whether the transaction is a prohibited tax shelter transaction.

(c) *Reliance on professional advice—(1) In general.* An entity manager is not required to obtain the advice of a professional tax advisor to establish that the entity manager made appropriate inquiries. Moreover, not seeking professional advice, by itself, shall not give rise to an inference that the entity manager had reason to know that a transaction is a prohibited tax shelter transaction.

(2) *Reliance on written opinion of professional tax advisor.* An entity manager may establish that he or she did not have a reason to know that a transaction was a prohibited tax shelter transaction at the time the tax-exempt entity entered into the transaction if the entity manager reasonably, and in good faith, relied on the written opinion of a professional tax advisor. Reliance on the written opinion of a professional tax advisor establishes that the entity manager did not have reason to know if, taking into account all the facts and circumstances, the reliance was reasonable and the entity manager acted in good faith. For example, the entity manager's education, sophistication, and business experience will be relevant in determining whether the reliance was reasonable and made in good faith. In no event will an entity manager be considered to have reasonably relied in good faith on an opinion unless the requirements of this paragraph (c)(2) are satisfied. The fact that these requirements are satisfied, however, will not necessarily establish that the entity manager reasonably relied on the opinion in good faith. For example, reliance may not be reasonable or in good faith if the entity manager knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.

(i) *All facts and circumstances considered.* The advice must be based upon all pertinent facts and circumstances and the law as it relates to those facts and circumstances. The requirements of this paragraph (c)(2) are not satisfied if the entity manager fails to disclose a fact that it knows, or reasonably should know, is relevant to determining whether the transaction is a prohibited tax shelter transaction.

(ii) *No unreasonable assumptions.* The advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the entity manager or any other person (including another party to the transaction or a material advisor within the meaning of sections 6111 and 6112).

(iii) *“More likely than not” opinion.* The written opinion of the professional tax advisor must apply the appropriate law to the facts and, based on this analysis, must conclude that the transaction was not a prohibited tax shelter transaction at a “more likely than not” level of certainty at the time the entity manager approved the entity (or otherwise caused the entity) to be a party to the transaction.

(3) *Special rule.* An entity manager’s reliance on a written opinion of a professional tax advisor will not be considered reasonable if the advisor is, or is related to a person who is, a material advisor with respect to the transaction within the meaning of sections 6111 and 6112.

(d) *Subsequently listed transactions.* An entity manager will not be treated as knowing or having reason to know that a transaction (other than a prohibited reportable transaction as defined in section 4965(e)(1)(C) and § 53.4965-3(a)(2)) is a prohibited tax shelter transaction if the entity enters into the transaction before the date on which the transaction is identified by the Secretary as a listed transaction.

(e) *Effective/applicability dates.* See § 53.4965-9 for the discussion of the relevant effective and applicability dates.

[T.D. 9492, 75 FR 38702, July 6, 2010]

**§ 53.4965-7 Taxes on prohibited tax shelter transactions.**

(a) *Entity-level taxes—(1) In general.* Entity-level excise taxes apply to non-plan entities (as defined in § 53.4965-2(b)) that are parties to prohibited tax shelter transactions.

(i) *Prohibited tax shelter transactions other than subsequently listed transactions—(A) Amount of tax if the entity did not know and did not have reason to know.* If the tax-exempt entity did not know and did not have reason to know

that the transaction was a prohibited tax shelter transaction at the time the entity entered into the transaction, the tax is the highest rate of tax under section 11 multiplied by the greater of—

(1) The entity’s net income with respect to the prohibited tax shelter transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year; or

(2) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction.

(B) *Amount of tax if the entity knew or had reason to know.* If the tax-exempt entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity entered into the transaction, the tax is the greater of—

(1) 100 percent of the entity’s net income with respect to the transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year; or

(2) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction.

(ii) *Subsequently listed transactions—*

(A) *In general.* In the case of a subsequently listed transaction (as defined in section 4965(e)(2) and § 53.4965-3(b)), the tax-exempt entity’s income and proceeds attributable to the transaction are allocated between the period before the transaction became listed and the period beginning on the date the transaction became listed. See § 53.4965-8 for the standard for allocating net income or proceeds to various periods. The tax for each taxable year is the highest rate of tax under section 11 multiplied by the greater of—

(1) The entity’s net income with respect to the subsequently listed transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year that is allocable to the period beginning on the later of the date such transaction is identified by the Secretary as a listed transaction or the first day of the taxable year; or